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### **Guanxi, Government and Corporate Reputation In China - Lessons for International Companies**

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# **Guanxi, Government and Corporate Reputation In China - Lessons for International Companies**

## **Conceptual Paper**

### **Purpose**

The purpose of this paper is to explore corporate reputation in the transitional Chinese context, and to examine the impact of guanxi on reputation management.

### **Methodology**

This is a conceptual paper based on extensive secondary research. Previous empirical studies by the author plus personal observation and anecdotal examples are used.

### **Findings /Arguments**

China remains a hierarchical guanxi-based society despite the rapid transition to a market-led economy. The decentralised business environment today is more complicated than that in the pre-reform era. As reputation is relationship based, guanxi is an important form of reputation capital. Corporate reputation in China is all about managing relationships with key stakeholders, the most important being the government. Government at the top level is crucial for reputation-building and deal-making. Given the idiosyncratic market conditions and differences in culture, MNCs have to adopt a localisation strategy in corporate communications, showing due respect for the local culture.

### **Research and Practical Implications**

Although Guanxi has been studied extensively its role in reputation building and promotion has yet to be fully understood. The paper establishes the link between the two concepts. International companies operating in China would also benefit from the insights offered here.

### **Originality/value**

The paper has made an original contribution to the understanding of the interplay between guanxi and reputation.

## **China's New Market Environment**

China is a complicated country full of contradictions. Everything you have heard about China is probably true, so is the opposite. The biggest paradox is the co-existence of old communist state politics and a new capitalist economy. This seems to be the root cause of all of China's achievements and problems. Despite the colossal changes in the economic and social environment, China has made literally no progress in reforming its political systems. When the Berlin Wall collapsed in 1989, many commentators predicted that the days of the Chinese Communist Party were numbered; eighteen years later, China is still a one-party state – the party has kept a firm grip over power and still exerts an enormous influence over every aspect of Chinese society. Whilst the control from the party and government over the economy and society in general has weakened, the political influence of the state remains ubiquitous. As there is no other political force in China that could provide a credible alternative, the only hope for democracy in China may lie in the Communist Party itself in its long and gradual transformation from a Leninist revolutionary organisation to a modern political governing party.

One of the key objectives in economic reform is the separation of the party/state from the direct management of the economy. To some extent this has been achieved. The central government has now less direct involvement in the running of the economy and the regulatory environment has become more transparent. Unfortunately, instead of making things simpler, the business environment today is even more complicated to international companies. In the old days of central planning, there was a single command system in every industrial sector – the ministry and its bureaus at provincial and city levels. One document with a red seal would guarantee the green light from

the top to bottom. After decentralisation, there are now many more players and stakeholders at different levels in the systems, each having different interests, political masters and guanxi networks. Given this complicated environment, no wonder that foreign businessmen are more confused about which “temple” they should pay visits to, and which one to visit first.

29 years after the start of economic reforms in 1978, China is still undergoing rapid economic and social changes. Facing intensified competition and more sophisticated consumers, how to develop and maintain corporate reputation poses a great challenge to international companies. The purpose of this paper is to explore corporate reputation in the changing Chinese context, with a special focus on the interplay between guanxi and reputation. It starts with a brief discussion of reputation and hierarchy concepts, followed by a detailed examination of guanxi and its link to reputation. Next it explains why government is the source of reputation and the most important stakeholder. Key factors affecting corporate communications are identified. Based on extensive research of secondary sources, the paper offers useful insights and advice to any companies that are doing business in China.

### **Hierarchy and Status**

Since two thousand years ago the Chinese bureaucracy remains the largest in the world as currently demonstrated by the ratio of civilian to bureaucrat at 26 to one. China is a hierarchical society with a larger power distance (Hofstede, 1980). In the pre-reform era, every organisation had a rank in the bureaucratic system; and every state employee, be it official, worker, actor or athlete, all had different rankings within the system. Although the state sector now accounts only for one quarter of the

national GDP, the state (i.e. the party) is still in firm control of everyday life. From ancient times Confucian values emphasised harmony and order, and believed that these could only be achieved through hierarchy and obedience. These traditional values are still prevalent as a guide to people's behaviour, such as governing by man rather than by law, obedience and loyalty to superiors, and deference to authority (Fan, 2000).

Understanding of hierarchy and status is crucial in order to appreciate how reputation is created in China. In a hierarchical society, people are constantly aware of their own status in relation to their environment. Chinese companies are obsessed with rankings and league tables. They regard published rankings, with media coverage and word of mouth, as important measures of corporate reputation (Hill & Knowlton, 2004). Advertisements and promotions are full of unqualified claims of being the best. This obsession is also reflected in urban construction – a race to become number one. The world's highest TV tower was completed in Guangzhou, the largest shopping mall opened in Beijing, and the highest skyscraper is currently under construction in Shanghai.

### **What is Corporate Reputation?**

Reputation is “the common or general estimate of a person with respect to character or other qualities; the relative estimation or esteem in which a person is held ... the honour or credit of a particular person or thing; one's good name, good report or fame in general” (*Oxford English Dictionary*, 2006). Corporate reputation can be defined in terms of a number of attributes that form a buyer's perception as to whether a company is well known, good or bad, reliable, trustworthy, reputable and believable

(Levitt, 1965). Corporate reputation is the representation of how an organisation is valued in terms of reliability, credibility, trustworthiness and responsibility by its various stakeholders over time (Fombrun, 1996), provides the firm with a valuable source of competitive advantage (Fombrun and van Riel, 2004). Corporate reputation is no longer viewed as a result of mere manipulation by the company, but as a result of an interactive process of corporate image production by the corporation and its various stakeholders (O'Neil, 1984; Olins, 1991). As beauty is in the eyes of the beholder, a company's reputation is relative and varies amongst different audiences. In this sense corporate reputation can be regarded as a kind of special relationship between the organisation and its various stakeholders.

Corporate reputation is a relatively new concept to many Chinese organisations. Traditional Chinese culture places great emphasis on personal reputation that is associated with a set of core values: virtue, moral consciousness, integrity, trustworthiness, having a sense of shame and fear of loss of face (Fan, 2000). In 1980s and 1990s, Chinese companies confused reputation with brand awareness, branding with advertising, in a naïve belief that advertising created brands. It was assumed that big spending would create mega brands, and once the firm became well known sales would automatically follow. Corporate identity was also in fashion during the whole 1990s. Firms spent millions changing their logo and promoting their new image. Many companies were initially satisfied with the "successful" effect of such campaigns but almost all ended in failure (Fan, 2006). Today Chinese companies have begun to take corporate reputation more seriously, but their understanding of the concept differs significantly from the West.

## **Guanxi as Reputation Capital**

Guanxi is a Chinese term referring to interpersonal connections with reciprocal obligations. Gold (1985) states “guanxi is a power relationship as one’s control over a valued good or access to it gives power over others”. Osland (1990) adds on: “...a special relationship between a person who needs something and a person who has the ability to give something.” Pye (1982) regards guanxi as “friendship with implications of continued exchange of favours”. Although the concept bears some similarity with Good Old Boy Network in the west, guanxi is unique in that it impacts on almost everyone and every aspect of Chinese society.<sup>1</sup>

Guanxi’s role in facilitating business in China has been widely debated in the literature (Yeung and Tung, 1996; Tsang, 1998; Abramson and Ai, 1999; Lovett, et al, 1999; Fan, 2002b). Guanxi is believed to create many benefits including: securing scarce resources, bypassing the bureaucratic maze, obtaining privileges and inside information, providing insurance against uncertainty and assistance or protection when problems arise (Fan, 2002a). Guanxi and reputation are similar concepts as both serve to reduce the probability that an exchange partner will act opportunistically (Standifird, 2006). In an official-centred society (Chen, 2004) that emphasises strong deference to authority, guanxi plays a key role in the development of reputation, as it would be much harder to do so from scratch. Guanxi could transfer reputation and some trust from one partner to another in the guanxi network, boosting the latter’s credentials. In other words, guanxi provides reputation capital. It is through the<sup>1</sup> network connection to important others that one establishes themselves as reputable.

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<sup>1</sup> A comprehensive critical review of guanxi literature can be found in Fan (2002a).

Both the quality and quantity of connections determines the level of reputation achieved (Tung and Worm, 2001; Standifird, 2006).

Reputation in China derives from two important sources: formally from official recognition, informally from guanxi recommendation. To a Chinese mind, the leader is the son of Heaven with a mandate to rule. The mass would dream of having a good emperor who is benevolent, wise and caring. Hence a firm's status or reputation is not obtained from the marketplace but conveyed from the top, i.e. official recognition. Photo opportunities of shaking hands with a state leader or minister and attending official functions would guarantee a headline in *the People's Daily* or the national Central Television's news bulletin that is more effective than paid ads and will convince the audience concerning the organisation's status, prestige and official recognition. Visitors to any Chinese organisations would be greeted first by the photos of high level handshakes and VIP visits, leaders' sayings or calligraphic inscriptions, certificates or silk banners of awards, all being displayed in the most prominent places. It is not uncommon for companies to obtain such official recognitions using guanxi, or in some worse cases, to buy the awards. In one national quality competition in 1993, 15 firms were awarded the first prize because they all paid the same price. The source of such official recognition is no longer confined to Chinese government. "Recognitions" from foreign governments or any international organisations also count. One pharmaceutical company used a letter from George W Bush to promote its new drugs on its website. The letter, an automated reply from the White House to any enquiring member of the public, had nothing to do with its product. It may take some time for Chinese companies to realise that real corporate reputation should come from the marketplace and stakeholders. A survey by Hill &



Knowlton (2004) concludes that CEOs in China do recognise the importance of corporate reputation and believe that a strong reputation helps to enhance a brand name, promote strategic partnerships, and recruit/retain employees. However, Chinese CEOs pay much less attention to the impact of corporate reputation on stock prices or its ability to help withstand the impact of a crisis than CEOs in North America, Europe or Asia. Product/service issues, unethical corporate behaviour and criticism from media and customers are seen as being the major threats to reputation by Chinese CEOs. It is interesting to note that there is much less concern about litigation, NGO criticism, and disasters that disrupt operations than that found among their global counterparts.

### **Guanxi as a Promotion Tool**

One important role of guanxi often overlooked in the literature is promotion. Guanxi can be used as a powerful tool to promote both the organisation and its products, and this promotion is cost effective and more powerful than conventional advertising. This is illustrated by the following two examples (Wang, 2003).

It has been a custom in China for companies to purchase various kinds of goods to give to their employees typically in the Chinese New Year, partly as a gesture of goodwill and partly as bonus or a component of their welfare. These goods should have both functional and symbolic values; as the employees would proudly show them to their family members and neighbours. The type or value of the goods reflects the status of the company. A Japanese bicycle company used guanxi to persuade the president of the largest local hospital to purchase their bicycles as the New Year gift for his 1000 strong staff. The effect of this deal was far greater than the sales of 1000 bikes itself as the word of mouth promotion quickly spread far and near through

employees to their relatives and friends, the doctors and nurses to their patients. The Japanese company soon became a household name in the city.

In China the wives of government officials are often said to have more power than their husbands. Many were involved in business dealings, legally or illegally, benefiting from the position of their husbands. They also accepted gifts (or bribes) on behalf of their husbands so the latter could avoid being blamed for corruption. A French wine merchant SB entering an eastern city faced strong competition from another French label FA that had been established in the market for several years. It would be impossible for SB to challenge FA's position using conventional promotion. An SB saleswoman was introduced to the wife of the city's party secretary while playing mah-jong – a good opportunity to develop guanxi. The wife was asked to help in promoting SB brand wine and promised with a big reward. She contacted all members in her guanxi network; one of them was the general manager of a large state-owned hotel who immediately joined the promotion of SB wine. The hotel was often used by the city leaders to entertain important guests and by large companies for corporate functions. SB wine started to appear on the local television and press as they routinely reported official events, then went on to become the market leader in six months. Government officials in this case had in fact played a role as 'celebrity' endorsers of a product. It worked well in circumstances when consumers genuinely believed that if the leaders preferred a certain brand, it must be good as they had good taste.

## **Government as the Key Stakeholder**

In China government plays a double role in corporate reputation. On the one hand, government is an important source of reputation; on the other hand, it is also the most important stakeholder. Despite continued reform, officials at various levels of government still have considerable power to approve projects, allocate resources, and arrange financing and distribution (Luo, 2001). Now it is even more crucial than ever for international companies to develop a good personal relationship with key government officials; there are a number of reasons for this. Firstly, all business relationships in China involve government as the country still remains a party-state in which the government holds absolute power, assuming the roles of legislator, law enforcer and judge. A latest example is the Chinese central government blocked the takeover bid by Carlyle Group of Xugong Construction Machinery, China's largest maker of building machinery. In a statement the council says "Big, key equipment manufacturers that plan to transfer stakes to foreign investors should seek opinion from relevant departments of the State Council," (International Herald Tribune, 2006). Secondly, the government owns vital resources, such as land and banks, and has control over all major types of media. And finally, the government has significant influence over other stakeholders. The survey by Hill & Knowlton (2004) confirms that government is regarded as a key stakeholder in corporate reputation in China, and that more emphasis is placed on government than in other parts of the world. Managing corporate government relations and communications are essential to achieve business objectives for MNCs. Effective government relations involve multi-level and multi-mode interactions. Given the new complexity in China's bureaucratic systems, "government" here refers to a large number of bodies at different levels:

- Central government – the State Council and responsible ministries or bureaus
- Local provincial or city government and its responsible departments

- Industry or trade associations, many of them either former government agencies or having close links with ministries
- Communist Party organisations and trade unions (affiliated to the Party)
- Other government departments that may indirectly affect business operation (e.g. public security bureau)

It is worth noting that government at the top level is of strategic importance, particularly for reputation building and deal-making, whilst government at lower level is important for operational purposes. Among all these various players the government ministry or department in charge of the specific industry has the crucial importance for MNCs. Although their power has been partly weakened compared with the pre-reform era, they still wield great power that could make or break a deal, as evidenced by the case of British American Tobacco (BAT). With more than 300 million smokers, China is the world's largest tobacco market accounting for one third of the total consumption. The tobacco industry has always been heavily regulated by the State Administration of Tobacco Monopoly (SATM) and all foreign investment projects must be approved by SATM. BAT entered the Chinese market in the early 1980s and spent a huge amount of resources cultivating guanxi and promoting their brands. BAT used to have a good relationship with SATM but was frustrated with the lack of progress in investment negotiations. The company decided to hold direct talks with local governments and central ministries, trying to bypass the red tape of SATM. Initially the strategy seemed to be effective, with BAT twice announcing the signing of large joint venture contracts with local partners in 2001 and 2004, but both projects were aborted because they failed to obtain the final approval from SATM. BAT's mistake gave Philip Morris, who entered the market later in 1990s, a rare opportunity to step in and became the winner: the firm signed a contract with the central government that would allow the company to manufacture Marlboro cigarettes in China for the first time ([www.globrand.com](http://www.globrand.com)).

## **The Limitations of Guanxi**

International companies should be aware of the difference between good guanxi and bad guanxi (Fan, 2002b; Vanhonacker, 2004). Good guanxi is about establishing a close friendship based on emotional ties, trust and long term mutual benefits. Bad guanxi, on the other hand, is based on pure utility and opportunism, and is often associated with bribes, kickbacks and material benefits. It is important to take careful consideration of legal and ethical issues in all guanxi transactions as bad guanxi could cause serious damage to corporate reputation. Some companies prefer the use of agents in order to shield them from the exposure when things went wrong. But this tactic is not completely risk-free, for example, Wal-Mart was recently implicated in a major corruption case when one director was found to have made a large illegal payment to a third party (globrand.com, 2006).

The relationship between MNCs and government is too important to leave to guanxi alone. Corporate government relations based solely on personal guanxi is fragile and unsustainable. Guanxi, by definition, is an asset owned by individuals and works only at personal levels (Tsang, 1998; Fan, 2002a). A person's guanxi becomes a temporary organisational asset only to the extent that this individual is willing to use his or her guanxi in order to achieve a specific organisational objective (Fan, 2002a, Standifird, 2006). In addition to ethical risks, guanxi could become a liability to the firm because of the potential conflicts between the employees' interest and the organisation's interest (Vanhonacker, 2004). Guanxi is only the first step in government relationship management, but is insufficient in terms of influencing government thinking and decisions. Guanxi is still important in doing business in China today but its role and functions have changed depending on the stage in the

MNC's operations (Fan, 2002a). In 2000, 75% of foreign direct investment or FDI into China went in as a form of joint venture and about 25% were wholly foreign-owned enterprises. The pattern has changed dramatically since 2003; two years after WTO accession, the figure was 70% for wholly foreign-owned enterprises and about 30% for joint ventures (Yueh, 2005). Without the assistance from their former joint venture internal partners MNCs now need external help, for example, from professional PR firms, in corporate government relationship management. With continuing improvement in the regulatory environment and better information, even Chinese firms are "starting to get smart by adopting something similar to the Western lobbyist approach" (Pederson, 2005).

### **Enhancing Reputation with Corporate Communications**

Corporate reputation management is about communicating to selected target audiences in order to influence or alter their perception of the firm, to create a positive image and goodwill. The idiosyncratic nature of the Chinese business environment presents a big challenge to corporate communications in China. Although traditional media still has more influence on a firm's corporate reputation the impact of new media especially the Internet is growing fast. The latest figure from the China Internet Network Information Centre (CNNIC, 2007) shows that the number of Internet users has risen by 35 percent over the previous year to more than 137 million in 2007, making China the second largest Internet user after the USA; and about 90 million people have broadband connections. A study of corporate communications by MNCs on the Internet finds that there are significant differences between the English and Chinese versions of their websites (Fan, 2002c). The content of FMCG brands' home page tended to be more localised than those of car or technology brands. No websites in different countries were found to be 100 percent standardised or 100 percent

localised. Most brands adopted a mixed approach in their web communications. Corporate communications on the Internet, like those using conventional media, is so complicated that there is no single formula to guarantee success. The study, however, has identified three groups of factors that influence the brand's communication strategy as well as its eventual effectiveness.

(Insert Table 1 about here)

### **Respect for Local Culture**

The differences between MNC's home market and foreign markets are the most important factors that affect communication strategy. Given those differences in culture, language and market conditions, the question is not about whether to adapt, but when and how to localise communications whilst still maintaining brand consistency and benefiting from global brand equity. Effective corporate communications in China requires MNCs to take cultural issues seriously and specifically design the message to appeal to the local audience. Edelman, a global PR firm, provides the following guidelines (2005):

- Emphasise the company's contribution to China (e.g. investment, employment, tax revenue, technology transfer etc.)
- Emphasise the company's long term commitment to China
- Present the company as a friend and responsible corporate citizen
- Frankly explain issues that the company has encountered in its operations
- Understand and respect national laws, regulations and local culture
- Show enough respect
- Be patient and adopt a long-term approach

Unilever's corporate website in China presents an almost perfect match for the above by highlighting its long-term commitment to the country, contribution to Chinese economy, and charity and CSR activities ([www.unilever.com.cn](http://www.unilever.com.cn)). Companies that ignore the cultural sensitivity of the local market may pay a heavy price as Toyota learnt recently in China (Fan, 2004). In two of its advertisements, one ad depicted a

traditional Chinese-style stone-carved lion - a symbol of Chinese culture- saluting a moving Toyota 4x4. To Chinese consumers, this was an insult to the Chinese national pride. The other ad showed a Land Cruiser pulling a cumbersome Chinese-made truck on a bumpy road, suggesting that Chinese made products were of inferior quality. Given the many similarities in culture between the two nations, it remains a mystery how Toyota could have make such a simple and grave mistake. Both advertisements caused a huge outcry amongst the Chinese public, many voicing their protest first over the Internet. In a country where most other types of media are still under the government's firm grip, the Internet has become a powerful yet less controlled channel in China. Toyota initially denied these charges but was later forced to withdraw both ads and made a public apology. But this was too little to late -Toyota's reputation was seriously damaged by this advertising debacle as a recent survey shows its reputation ranking dropped to a lowly 79<sup>th</sup> position despite a long history in China and a previously good image in the market (Fombrun and Pan, 2006).

Luo (2001) identifies four building blocks for the cooperative relationships between MNCs and host governments: resources commitment, personal relations, political accommodation and organisational credibility. Political accommodation refers to the responsiveness to the social needs of a host nation through charitable activities, which now becomes another effective way to develop corporate reputation in China. Microsoft asked APCO, a global communications consultancy, to help enhance its reputation in China and expand its efforts to bridge the "digital divide". APCO decided to focus on the issue of unemployment as the result of the closure of many state-owned enterprises. It helped design and implement a computer skills training programme for laid-off workers. The initiative generated massive media attention and



allowed Microsoft to strengthen relationships with local government officials. As well as demonstrating how the media can now be used in ways unthinkable even a decade ago, the project also showed how commercial and political interests can be exploited to create government goodwill and a positive public image (EIU, 2004)

## **Conclusions**

When MNCs first entered the Chinese market in the early 1980s they faced little or no competition from domestic companies and received genuine fondness from Chinese consumers even though many of them could only dream of owning foreign products because of their high prices. The reputation enjoyed by MNCs derived partly from their good quality or design as well as a country of origin effect (i.e. products from developed countries were generally perceived favourably in developing markets). This honeymoon period ended in the later 1990s when MNCs found themselves facing increasing competition not only from other international firms but also from local Chinese companies narrowing the gap in quality and offering the market lower prices and better service. Many international companies have seen erosion of their reputational advantage and goodwill. Sony is case in point: once highly respected in China, the company has recently suffered a barrage of negative publicity and slipped to the 41<sup>st</sup> place in the recent RepTrak resurvey (Fombrun and Pan, 2006).

Most industries in China are now characterised by intensified competition, mass over capacity and decreasing margins. A recent survey of 600 consumers in four cities by a US consulting company confirmed that Chinese consumers were no longer concerned only about price. Quality, service and choice were the top three criteria in their

purchasing decisions, whilst price was ranked in fifth position. They also developed loyalty to their preferred brands (*China Quality News*, 2004).

Under this new environment, MNCs have to work harder to develop or enhance their reputation. Constant interaction with government at different levels and effective adjustments in business strategies in response to changing government policies will be the most critical factor in China – the message from the second annual Summit on Government Relationship Management held in Beijing in April 2005 (*China Daily*, 2005). Given idiosyncratic market conditions and differences in culture, what works in the West will not necessarily work in China. Even within China, strategies and tactics working in one region or sector give no guarantee for success in another region or sector. Understanding hierarchy and guanxi, taking note of cultural differences and making adaptations accordingly hold the key to effective communication. International companies need to place more emphasis on corporate reputation, which, together with corporate government relations, should become a central part of their political strategy.

**Table 1 Factors influencing communications on the Internet**

<i>Market specific</i>	<i>Firm specific</i>	<i>Communication specific</i>
Language	Purpose and objectives	Corporate v brand
Cultural values	Product features	Target audience: Influencer v end user
Consumer needs and tastes	Brand positioning	Function of website: e.g. Flat v interactive
Other environmental factors	Country of origin effect	Web design considerations: Layout, style etc.

Source : Fan (2002c)

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